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Demand shocks and productivity growth

António Gomes de Menezes*

University of the Azores, Department of Economics and Management, 9501-801 Ponta Delgada, Portugal and CEEAplA (e-mail: menezesa@notes.uac.pt)

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Abstract. This paper presents evidence on the relationship between cyclical shocks and productivity growth, for 20 2-digit SIC US manufacturing industries and a set of monetary policy, fiscal policy, and oil price shocks. The paper uses as a measure of productivity change a Solow residual corrected for a wide range of non-technological effects due to imperfect-competition, non-constant returns to scale, and cyclical utilization rates of capital and labor services. The empirical framework identifies policy shocks independently of productivity measurement issues via a two-step procedure. While the typical industry shows weak responses of productivity to the shocks considered, in some industries temporary contractionary policy shocks lead to increases in productivity. In addition, the results reveal that there are localized asymmetries, with contractionary policy shocks having larger productivity effects than their expansionary counterparts. The results support the thesis that job reallocation is an important channel linking contractionary policy shocks and productivity growth. These results support the *pit-stop* view of downturns.

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